IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

HARLEYSVILLE MUTUAL INSURANCE COMPANY Plaintiff, v. GE REINSURANCE CORPORATION Defendant.	: : : : : : : :	CIVIL ACTION NO. 02-171

M E M O R A N D U M

Newcomer, S.J. May , 2002

Plaintiff's Motion to Strike Portions of the Affidavit of Frank J. Kehrwald, Defendant's Motion for Summary Judgment, and Plaintiff's Motion to Dismiss Certain Counterclaims and Strike Certain Affirmative Defenses are presently before the Court.

I. BACKGROUND

Plaintiff is an insurance company located in Harleysville, Pennsylvania. Defendant is an insurance company located in Barrington, Illinois. In this case, Plaintiff sues Defendant for breach of contract, specific performance, and a declaratory judgment in connection with a Quota Share Reinsurance Agreement (the "Quota Agreement"). Under the Quota Agreement, Defendant reinsured Plaintiff for a nonstandard automobile insurance program in the State of California.[1] An entity called

[1]Nonstandard automobile insurance generally includes the underwriting of higher risk insurance policies with

Access General Insurance Company of California ("Access General") managed the program pursuant to an agreement between Harleysville and Access General (the "Access General Agreement").

The Quota Agreement is divided into Articles with Article 13 providing for arbitration and/or litigation. The following are the relevant portions of Article 13:

> 13.1 As a condition precedent to any right of action hereunder, in the event of any dispute. . . with respect to this Agreement, including its formation. . . it is hereby mutually agreed that such dispute. . . shall be submitted to arbitration.
>
> 13.6 In the event that the amount of any claim or counterclaim made in any such arbitration is in excess of Two Million Dollars ($2,000,000), including such calculation all amounts of compensatory and punitive damages, upon written election of either party to the other, such claim or counterclaim shall not be subject to arbitration. . .
>
> 13.7 In the event of a dispute between [Plaintiff and Defendant] concerning this Agreement and the [Access General Agreement] (regardless of whether either party has claims against [Access General]) the entire dispute. . . shall be subject to arbitration as provided in this Article.

The Quota Agreement further states that it "is the entire agreement between the parties and supersedes any and all previous agreements, written or oral, and amendments thereto." Quota Agreement, at ¶ 21.6. Additionally, Article 17.5 sets forth the following:

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commensurately higher premiums. See Plaintiff's Complaint, at ¶ 8.

> Reinsurer [GE] warrants and represents that it has conducted its own due diligence of the business operations of the General Agent [Access General] including but not limited to the rates and forms used by the General Agent and the General Agent's ability to accurately report the necessary data and information. The Reinsurer shall not sue or seek arbitration against the Company [Harleysville] for any claims or causes of action arising from or relating to General Agent's operations, including but not limited to the use of the rates and forms in effect at the effective date of this Agreement.

In its Answer, Defendant raises several counterclaims, which in essence, claim that after Plaintiff discovered that one of its insurance programs was going to generate significant losses, it sought a reinsurance program from Defendant. Specifically, Plaintiff raises, among others, the following counterclaims: 1) Count I, Fraud; 2) Count II, Breach of the Duty of Utmost Good Faith; 3) Count III, Bad Faith; 4) Count IV, Unilateral Mistake; 5) Count V, Negligent Misrepresentation; and 6) Count VI, Known Loss. Defendant also raises several affirmative defenses in its Answer, including the following ones: 1) Second Affirmative Defense alleging that Plaintiff's claims in Counts I, II, and III are barred by fraud; 2) Third Affirmative Defense alleging Plaintiff's claims in Counts I, II, and III are barred by Plaintiff's breach of its duty of utmost good faith; 3) Fourth Affirmative Defense alleging Plaintiff's claims in Counts I, II, and III are barred by Plaintiff's breach of its duty of good faith; 4) Fifth Affirmative Defense alleging Plaintiff's claims in Counts I, II, and III are barred by Plaintiff's

negligent misrepresentations; and 5) Sixth Affirmative Defense alleging Plaintiff's claims in Counts I, II, and III are barred by operation of the known loss doctrine.

In a December 28, 2002 letter to Plaintiff, Defendant demanded arbitration invoking Article 13 of the Quota Agreement. On January 7, 2002, Plaintiff notified Defendant, pursuant to paragraph 13.6 of the Quota Agreement, of its election to address the parties' dispute in Court. Plaintiff filed this action on January 11, 2002.

On January 25, 2002, Defendant filed a Motion to Dismiss and/or Stay and To Compel Arbitration, and on February 12, 2002, this Court denied that Motion finding that "this case is properly before the Court under paragraph 13.6 of the parties' agreement." Now, in their Motion for Summary Judgment, Defendant again argues that this case should be arbitrated. In support of that Motion, Defendant has submitted the affidavit of Frank J. Kehrwald, Defendant's General Counsel. Plaintiff has responded to that Motion, and in its response, Plaintiff has moved the Court to strike paragraphs 12 through 17 of Mr. Kehrwald's affidavit. Plaintiff has also moved to dismiss the counterclaims and affirmative defenses listed above, and Defendant has responded to Plaintiff's Motion. The Court now turns to the parties' motions.

II. DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

A. Legal Standard

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c) (1994). The party moving for summary judgment has the initial burden of showing the basis for its motion. Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986). Once the movant adequately supports its motion pursuant to Rule 56(c), the burden shifts to the nonmoving party to go beyond the mere pleadings and present evidence through affidavits, depositions, or admissions on file to show that there is a genuine issue for trial. Id. at 324.

Further, under Federal Rule of Civil Procedure 56(e), affidavits supporting a motion for summary judgment "shall set forth such facts as would be admissible in evidence." Fed. R. Civ. P. 56(c). Accordingly, the Court may strike an affidavit containing testimony that would be barred by the parol evidence rule. See Berger Realty Group, Inc. v. Pullman, 1986 WL 7919, at *6-*7 (E.D.Pa. Jul 16, 1986).

B. Arbitration

Defendant argues that this case is subject to

arbitration and in support of its arguments, Defendant offers the affidavit of Frank J. Kehrwald, Defendant's General Counsel. In response, Plaintiff has moved the Court to strike paragraphs 12 through 17 of Mr. Kehrwald's affidavit based upon the parol evidence rule. Thus, for this Court to resolve whether this case should be arbitrated, it must first resolve whether that affidavit should be stricken.

In Pennsylvania, "if a written contract is unambiguous and held to express the embodiment of all negotiations and agreements prior to its execution, neither oral testimony nor prior written agreements or other writings are admissible to explain or vary the terms of that contract." Lenzi v. Hahnemann University, 664 A.2d 1375, 1379 (Pa. Super. Ct. 1995). Whether a writing constitutes an integrated contract is a question of law. Id. (citing Murray v.University of Pennsylvania Hospital, 490 A.2d 839 (Pa. Super. Ct. 1985). A contract is integrated if it represents a final and complete expression of the parties' agreement. Id.

Additionally, a contract is ambiguous only if it is reasonably susceptible of different constructions, and is capable of being understood in more than one way. Samuel Rappaport Family Partnership v. Meridian Bank, 657 A.2d 17, 21 (Pa. Super. Ct. 1995). However, a contract is not ambiguous merely because parties do not agree upon the proper construction of the

contract. Seven Springs Farm, Inc. v. Croker, 748 A.2d 740, 744 (Pa. Super. Ct. 2000).

Here, the Court finds that the Quota Agreement is clear and unambiguous. As discussed in more detail below, Article 13 clearly created a system where certain disputes are subject to arbitration, but other larger disputes may be litigated in Court. Further, the Court finds that the Quota Agreement represents the parties' entire agreement, and represents the parties' final and complete expression of that agreement. Indeed, the parties agreed that the Quota Agreement "is the entire agreement between the parties and supersedes any and all previous agreements, written or oral, and amendments thereto," Quota Agreement, at ¶ 21.6. The effect of such a clause is to make the parol evidence rule particularly applicable. See McGuire v. Schneider, Inc., 534 A.2d 115, 117-18 (Pa. Super. Ct. 1987). In light of the parties' integration clause, and the overall structure of the contract, the Court concludes that the Quota Agreement is integrated and clear, and paragraphs 12 through 17 of Mr. Kehrwald's affidavit are not admissible because they are intended to explain or vary the terms of the parties' agreement. See Kehrwald Affidavit, at ¶¶ 12-17.

With those paragraphs stricken, the Court will now address whether the Quota Agreement mandates that the parties arbitrate this case. The Court notes that there is a strong

federal policy favoring the arbitration process. See Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 25 (1991) (noting that the Federal Arbitration Act manifests a liberal federal policy favoring arbitration agreements). Thus, "where the contract contains an arbitration clause, there is a presumption of arbitrability. . . 'unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.'" AT & T Techs., Inc. v. Communications Workers of Am., 475 U.S. 643, 648 (1986)(quoting United Steelworkers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574, 584-85 (1960)). However, "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit." Id. at 648. Further, an express provision excluding a particular grievance from arbitration may overcome the presumption of arbitrability. See id., at 650.

Just as it was on February 12, 2002, the Court remains convinced that this case is properly before the Court under paragraph 13.6 of the Quota Agreement. That paragraph allows a party to elect litigation in court instead of arbitration when "the amount of any claim or counterclaim made in any such arbitration is in excess of Two Million Dollars ($2,000,000). . . ." Here, Defendant does not dispute that the claims or counterclaims exceed two million dollars, or that the

Defendant properly exercised its litigation option.

When arguing that paragraph 13.6 does not cover this case, Defendant contends that because paragraph 13.6 uses the word "claim", that paragraph was only intended to govern "liquidated claims in excess of 2.0 million arising from the underlying insurance program." Defendant's Memorandum of Law in Support of Motion for Summary Judgment, at 5. However, the Court finds that this is a strained interpretation that makes little sense in light of whole Quota Agreement. The Quota Agreement does not concern itself with individual claims made on any underlying insurance policies. Further, Defendant's interpretation does not comport with that paragraph's use of the word "counterclaims"; Defendant fails to argue, and the Court doubts it could, that "counterclaim" is a term of art in the insurance industry. Finally, to prove its interpretation, Defendant cites paragraph 12 of Mr. Kehrwald's affidavit, but that paragraph has been stricken. Thus, the Court is left to interpret the plain meaning of the word "claim". E.g., CGU Ins. v. Tyson Assoc., 140 F. Supp.2d 415, 421 (E.D.Pa. 2001)("An insurance contract must be construed according to the plain meaning of its terms. . ."). The Court cannot say that the plain meaning of the word "claim" in paragraph 13.6 does not encompass this case. As the Quota Agreement bound only Plaintiff and Defendant, the Court finds the word "claim" means claims between

them, and that this case involves such a claim.

Defendant contends that this dispute is subject to arbitration under paragraphs 13.1 and 13.7 of the Quota Agreement. Paragraph 13.1 states generally that "in the event of any dispute. . . with respect to this Agreement, including its formation. . . it is hereby mutually agreed that such dispute. . . shall be submitted to arbitration." However, paragraph 13.1 does not address claims or counterclaims in excess of two million dollars; only paragraph 13.6 specifically does that. It is a general principle of contract law that, where two provisions of a contract are inconsistent, general language must yield to more specific language. Affiliated Food Distributors, Inc. v. Local Union No. 229, 483 F.2d 418 (3d Cir. 1973); see also Restatement (Second) Contracts § 203. Thus, paragraph 13.1 must yield to paragraph 13.6. Defendant's argument that paragraph 13.6 does not cover this dispute because this dispute involves the formation and validity of the Quota Agreement is also unavailing. Paragraph 13.6 governs "any claim or counterclaim" in excess of two million dollars, and nothing in paragraph 13.6, or elsewhere, suggests that those claims and counterclaims cannot concern disputes about formation and validity.

Defendant also argues that paragraph 13.7 compels arbitration because it contends its counterclaims for fraud, breach of the utmost duty of good faith, and bad faith concern

both the Quota Agreement and the Access General Agreement. Those counterclaims each allege that Defendant is liable for "misrepresenting to [Plaintiff] that the [Access General Agreement] required Access General to issue policies based on the rates and rating factors of the Coast National Program." Defendant's Counterclaim, ¶¶ 29(b), 36(b), 43(b). As illustrated above, paragraph 13.7 of the Quota Agreement states that:

> In the event of a dispute between [Plaintiff and Defendant] concerning this Agreement and the [Access General Agreement](regardless of whether either party has claims against [Access General]) the entire dispute. . . shall be subject to arbitration as provided in this Article.

Thus, according to the plain meaning of paragraph 13.7, where a dispute between Plaintiff and Defendant involves both the Quota Agreement and the Access General Agreement, that dispute is subject to arbitration as provided in Article 13 of the Quota Agreement. Accordingly, paragraph 13.7 must be read "subject to" paragraph 13.6. As such, because this case involves claims or counterclaims in excess of two million dollars, Plaintiff has properly elected to litigate this case here under paragraph 13.6. Contrary to Defendant's contention, this interpretation does not render paragraph 13.7 meaningless. Indeed, if a dispute involved less than two million dollars, and involved both the Quota Agreement and the Access General Agreement, paragraph 13.7 would mandate arbitration. Moreover, without paragraph 13.7, parties might have to litigate disputes involving the Quota Agreement,

but arbitrate disputes concerning the Access General Agreement.

In the end, the Quota Agreement simply allows the parties to take the big cases to court, and requires that they arbitrate the smaller ones. E.g., Higman Marine Services, Inc. v. BP Amoco Chemical Co., 114 F. Supp.2d 593, 597 (S.D.Tex. 2000)(interpreting a similar agreement and stating that the parties "intended to convey the simple idea that 'big' disputes may go to court while 'little' disputes must go to arbitration"). For these reasons, the Court will deny Defendant's Motion for Summary Judgment, and once again finds that this case is properly before the Court under paragraph 13.6 of the Quota Agreement.

III. PLAINTIFF'S MOTION TO DISMISS CERTAIN COUNTERCLAIMS AND STRIKE CERTAIN AFFIRMATIVE DEFENSES

Plaintiff first moves to dismiss and strike Defendant's counterclaims I through VI pursuant to Federal Rules of Civil Procedure 12(b)(6) and 12(f). Second, Plaintiff moves to strike Defendant's Second, Third, Fourth, Fifth and Sixth Affirmative Defenses pursuant to Rule 12(f).

A. Legal Standard

1. Under Rule 12(b)(6)

The standard for dismissal of a counterclaim does not differ from the standard for dismissal of a complaint. United States v. Union Gas Co., 743 F. Supp. 1144, 1150 (E.D.Pa. 1990). When evaluating a Motion to Dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), the Court must accept each allegation

in a well pleaded complaint as true. Albright v. Oliver, 510 U.S. 266, 268 (1994). Additionally, a Motion to Dismiss should only be granted if the Court finds that no proven set of facts would entitle the non-moving party to recovery under the filed pleadings. Conley v. Gibson, 355 U.S. 41, 45-46 (1957).

It is also firmly established that in reviewing a Federal Rule of Civil Procedure 12(b)(6) motion, the Court must draw all reasonable inferences in the plaintiff's favor. Schrob v. Catterson, 948 F.2d 1402, 1405 (3d Cir. 1991).

2. Under Rule 12(f)

Under Rule 12(f), a court may strike "from any pleading any insufficient defense or any redundant, immaterial impertinent, or scandalous matter." Fed. R. Civ. P. 12(f). Generally, motions to strike will be denied unless the allegations have no possible relation to the controversy and may cause prejudice to one of the parties. Environ Products, Inc. v. Total Containment, Inc., 951 F. Supp. 57, 59 (E.D.Pa. 1996) (citing Wright & Miller, Federal Practice and Procedure § 1382 at 704 (1990)). To strike an affirmative defense, the Court must be convinced that there are no questions of fact, that any questions of law are clear and not in dispute, and that under no set of circumstances could the defenses succeed. Union Gas Co., 743 F. Supp. at 1150; Smith, Kline & French Laboratories v. A.H. Robins Co., 61 F.R.D. 24, 33 (E.D.Pa. 1973). Nevertheless, a motion to

strike is the proper procedure to eliminate insufficient defenses and save the time and expense which would otherwise be spent in litigating issues that would not affect the outcome of the case. Union Gas Co., 743 F. Supp. at 1150; United States v. Geppert Bros., Inc., 638 F. Supp. 996, 998 (E.D.Pa. 1986).

B. Defendant's Counterclaims and Affirmative Defenses

Plaintiff argues that Defendant's counterclaims I through VI and second through sixth affirmative defenses are barred by the Article 17.5 of the Quota Agreement. Article 17.5 sets forth the following:

> Reinsurer [GE] warrants and represents that it has conducted its own due diligence of the business operations of the General Agent [Access General] including but not limited to the rates and forms used by the General Agent and the General Agent's ability to accurately report the necessary data and information. The Reinsurer shall not sue or seek arbitration against the Company [Harleysville] for any claims or causes of action arising from or relating to General Agent's operations, including but not limited to the use of the rates and forms in effect at the effective date of this Agreement.

Accordingly, Plaintiff argues that Defendant expressly agreed that it would not sue Plaintiff on causes of action arising from Access General's rates, and stated expressly that it had conducted its own investigation into Access General's rates. Thus, Plaintiff argues that this Court should strike the counterclaims and affirmative defenses because they each allege, in some form, that Plaintiff misled Defendant about Access General's rates.

Upon a review of Defendant's counterclaims and affirmative defenses, and because Defendant does not disagree, the Court finds that Defendant's counterclaims and affirmative defenses do allege, in essence, that Plaintiff misled Defendant about Access General's rates. In light of Defendant's express statement that it conducted its own investigation into Access General's rates, and its contractual promise not to sue Plaintiff for any claims arising from Access General's rates, Defendant cannot now allege that Plaintiff misled Defendant about Access General's rates in a counterclaim or affirmative defense.

When interpreting a contract, the Court's fundamental goal is to give effect to the parties' intent. Hutchison v. Sunbeam Coal Corp., 519 A.2d 385, 389 (Pa. 1986); Anchel v. Shea, 762 A.2d 346, 352 (Pa. Super. Ct. 2000). Here, to allow Defendant to allege that Plaintiff misled Defendant about Access General's rates would disregard the unambiguous language in paragraph 17.5 of the Quota Agreement. According to that language, Defendant assumed the burden of investigating Access General's rates for itself. Thus, Defendant's counterclaims and affirmative defenses would impose obligations upon Plaintiff that Plaintiff specifically contracted to avoid. See Agrecycle, Inc. v. City of Pittsburgh, 783 A.2d 863, 867 (Pa. Cmwlth. Ct. 2001) (concluding that a breach of the duty of good faith claim fails under Pennsylvania law where Defendant "specifically contracted

to avoid such duty in the [parties'] Agreement.").

Defendant contends that Article 17.5 does not bar its counterclaims and affirmative defenses because that Article only relates to Access General's "business operations." However, as discussed above, Article 17.5 is not so narrow, and does encompass Defendant's counterclaims and affirmative defenses here. Consequently, the Court finds that dismissal of these counterclaims and affirmative defenses is proper. Similarly, the Court will strike those claims and defenses because there are no facts in dispute, the law is clear, and under no set of circumstances could the claims and defenses succeed.

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Clarence C. Newcomer, S.J.